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# Microfinance Regulation and Effective Corporate Governance in Nigeria and Zambia


## Structured Abstract

**Purpose**: There have been various forms of regulatory intervention by the central banks of countries in order to streamline microfinance activities and ensure effective corporate governance of microfinance institutions. Considering the limited amount of research in this area and the need to ensure regulatory effectiveness, the purpose of this paper is to evaluate the impact of regulatory provisions on the attainment of effective corporate governance in microfinance institutions in Nigeria and Zambia.

**Methodology**: Interviews were conducted with regulators at the Central Bank of Nigeria and the Bank of Zambia, directors and executive management officers of microfinance institutions, and executives of apex associations of microfinance institutions in both countries.

**Findings**: The paper presents 5 significant findings which are that the regulations have enabled negative outcomes in areas such as board composition, the ownership requirements in the regulations have resulted in differing governance implications, the certification requirements for board members are problematic in practice, supervision by regulators is ineffective and impacts on risk management, and the principle of consultation with stakeholders is inadequate in both countries.

**Practical Implications**: Regulatory provisions must be robust and fit for purpose in order to ensure the microfinance initiative in emerging economies achieves the objectives of enhancing financial inclusion and economic development of the society.

**Originality/Value**: The paper addresses an area of limited research and provides empirical findings in relation to regulation and corporate governance in developing economies, which would help to ensure regulatory effectiveness.

**Key Words**: Corporate Governance; Microfinance; Regulation; Nigeria; Zambia.

**Article Classification**: Research Paper.

**Introduction**

Corporate governance is a system which is aimed at ensuring that organisations pursue their goals and objectives in an efficient and effective manner. Various definitions of corporate governance exist and include that it deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer and Vishny, 1997, 737) and that it is the system by which companies are directed and controlled (Cadbury, 1992). Du Plessis (2009) also argues that corporate governance is the process of regulating and overseeing corporate conduct and of balancing the interest of all internal stakeholders and other parties who can be affected by the corporation's conduct in order to ensure responsible behaviour by corporations and to achieve the maximum level of efficiency and profitability for a corporation. From the foregoing, it becomes evident that organisations need to engage with effective corporate governance in order to meet their objectives. The issue of effective governance can be argued as being dependent on the perspective of the particular organisation, but it can also be viewed more generally by taking cognisance of what is widely considered as best practice in terms of corporate governance.

In the realm of microfinance, corporate governance has become an important issue for the reason that microfinance is delivered through organisational structures. It has been argued that corporate governance in the context of microfinance refers to the mechanisms through which donors, equity investors and other providers of funds assure themselves that their funds will be utilised in accordance with the intended purposes (Hartarska, 2005, 1628).

Microfinance is described largely as a developmental initiative aimed at poor and low income people. It developed as an instrument to reduce poverty and ensure sustainable economic development, and was pioneered by Non-Governmental Organisations (NGOs) and not-for-profit entities (Varottil, 2013, 244). The main aim of microfinance organisations is to serve the poor by extending financial services such as loans, savings products, insurance etc. (Tadele and Rao, 2014, 21). Essentially, microfinance is defined by Rosenberg et al (2009) as the provision of financial services to poor and low-income clients who have little or no access to conventional commercial banks. The microfinance drive was initiated by Nobel Peace Prize winner, Muhammad Yunus and the Grameen Bank project in Bangladesh (BBC, 2011). His view is that the poor can be helped to create wealth and that microfinance should be delivered as a social business (Yunus, 2008). For the reason that poverty is an enormous problem in numerous parts of the world, microfinance has been adopted as a key mechanism for economic enhancement and development by various countries. Also, microfinance was developed as a private response to the unsatisfactory results of government programmes aimed at poverty reduction (Macchiavello, 2012, 131). There has been various forms of regulatory intervention by the central banks of countries in order to streamline microfinance activities. According to Ahmed et al (2013, 219), microfinance is too important to allow it to operate without government oversight. An important reason for the regulation of microfinance is argued to be for the purposes of ensuring effective governance of microfinance institutions (MFIs). In fact, the necessity for good governance in microfinance institutions has been confirmed in extensive research and there are suggestions that investors are hugely concerned with the quality of corporate governance in MFIs (CSFI, 2011 and 2012).

Corporate governance is about adequate accountability, but it is also a mechanism which contributes to the achievement of the goals of microfinance institutions such as increased financial performance and outreach (Mersland and Strom, 2007). Therefore, the question as to whether the corporate governance of MFIs is effective is a crucial one. In terms of determining effectiveness in corporate governance arrangements in MFIs, a good starting point is an examination of the principles expounded in literature and evidence based reports. Handbooks and guidance have been published to aid MFIs in creating effective corporate governance (Pistelli et al, 2012; Council of Microfinance Equity Funds, 2012; Ledgerwood et al, 2013). For example, Pistelli et al indicate that issues such as board structure and characteristics, board engagement and risk management mechanisms are clear indicators of effective governance. The Council of Microfinance Equity Funds stated that good governance has become increasingly important in microfinance which is now delivered through 'for-profit' limited liability companies and their corporate governance principles for MFIs provides practical guidance for stakeholders, investors, board members and senior management. The Council also recognised the existence of internal and external actors in the governance process. The internal actors include the board of directors and senior management. The external actors include investors, clients and regulators. As regards regulators such as central banks, there is certainly an incentive on their part to ensure that MFIs are governed effectively as their financial and social performance contributes to the macro-economy, financial inclusion and poverty alleviation. It is, therefore, worthwhile to evaluate the efforts undertaken by regulators towards creating effective corporate governance in MFIs through the form of regulatory provisions.

This paper evaluates the extent to which regulatory provisions enacted by the Central Bank of Nigeria (CBN) and the Bank of Zambia (BOZ) has contributed to effective corporate governance in MFIs in both countries. In general, there is limited research in the area of the corporate governance of microfinance institutions in these countries. Most of the available literature on the subject of microfinance in these countries have focused on the impact of microfinance on poverty alleviation and outreach issues (Nwankwo et al, 2013; Ogujiuba et al, 2013; Jegede et al, 2011; Abraham and Balogun, 2012; Kazi and Leonard, 2012). The analysis in this paper is based on a research project undertaken by conducting interviews with the regulators, as well as MFI board and management executives. Nigeria and Zambia developed their microfinance policies in 2005 and 2006 respectively, with Nigeria revising its policy in 2011 and the Zambian policy undergoing a revision presently. In the Revised Nigerian Microfinance Policy (Revised MPRSF 2011, 13), it is stated that the prolonged sub-optimal performance of microfinance institutions due to incompetent management, weak internal controls, poor corporate governance, amongst other reasons, justified the introduction of the microfinance policy. Section 6.13 of that policy deals with corporate governance of MFIs and states that all MFIs shall adhere to basic governance principles. The CBN also issued a Revised Regulatory and Supervisory Guidelines for Microfinance Banks (MFBs) in 2012 (Revised RSG 2012), which included a section relating to boards and management (section 4), as well as a recommended minimum operational template for MFBs that covers corporate governance arrangements (section 22). In Zambia, The Banking and Financial Services (Microfinance) Regulations 2006 (BFSR 2006) and Part VI of the Draft Banking and Financial Services (Regulations) 2014 (Draft BFSR 2014) also address governance issues in MFIs.

The key contribution of this paper to the literature and issues of development lies in the novel manner in which it engages with the problems around corporate governance regulation in these two African countries which are situated in different parts of the continent but have adopted similar approaches to microfinance regulation. It is pertinent to evaluate the impact of these efforts at regulation in order to ensure that it is not an exercise in futility. A comparison of outcomes in both countries is also essential, so as to enhance the understanding of regulatory outcomes in different locations. The paper discusses five significant findings in relation to corporate governance based on the research conducted and they are as follows: (i) The rationale and aims of regulatory intervention in Nigeria and Zambia is similar and the improvement of corporate governance was clearly one of the important objectives. Nevertheless, regulatory intervention has resulted in positive outcomes in some areas such as board and board committee establishment, but has enabled or led to negative outcomes in some other areas such as board characteristics and board composition. (ii) Regulation by the CBN in Nigeria has resulted in regulated MFIs being metamorphosed into MFBs whilst in Zambia, the BOZ regulatory provisions allow for limited liability companies to operate as deposit taking MFIs and other forms of organisations to operate as non-deposit taking MFIs. Therefore, the legal and organisational structure of MFIs in both countries, as well as the nomenclature, inevitably leads to differing governance structures and implications. (iii) The Nigerian CBN regulatory provisions mandate a certification programme for board members and management officers of MFBs and the Zambian BOZ regulations mandate a 'fit and proper person test' for board and management of MFIs. Both regulatory provisions are found to be problematic in practice and arguably ineffective. (iv) The supervision of MFIs by regulators is problematic in both countries, an outcome which raises pertinent questions around the issue of effective risk management. (v) The principle and process of consultation with stakeholders in the microfinance sector is inadequate in both countries, highlighting problems in relation to regulatory legitimacy, effectiveness and sustainability.

The rest of the paper is structured as follows: Section A discusses relevant literature and theories in the areas of corporate governance and microfinance. Section B presents the methodology adopted in the research and explains the approaches adopted. Section C presents a highlight of the microfinance regulatory landscape in Nigeria and Zambia. Section

D then engages in a detailed discussion of the findings. Section E concludes the paper and presents suggestions for future research.

## A. Literature Review

According to Tricker (2015, 3-4), corporate governance is a subject of primary focus for the 21st century and it essentially covers the activities of the board, its relationship with shareholders and managers, as well as with auditors, regulators and other legitimate stakeholders. Mallin (2013, 7-8) argues that corporate governance is fundamental in ensuring that companies operate at optimum efficiency and the key features of an effective corporate governance system include ensuring that adequate controls are in place to safeguard assets, preventing single individuals from wielding too much influence, ensuring an effective relationship between the board, management, shareholders and other stakeholders, ensuring that the company is managed in the best interests of the shareholders and stakeholders, and encouraging transparency and accountability. The purpose of corporate governance is, therefore, to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of a company. Cheffins (2015) argues that corporate governance is about checks and balances and the corporate failures of years past have projected the topic into great significance. In the area of microfinance, a study of failures in the sector indicated that the clearest and strongest conclusion drawn was that an MFI's governance structure proved to be the primary differentiating factor between those entities that overcame a crisis and those that did not (Marulanda et al, 2010, 47).

There has been a limited amount of research done in relation to corporate governance in the microfinance sector (Estape-Dubreuil and Torreguitart-Mirada, 2015, 139), despite its significance in creating effective outcomes in MFIs. Also, it has been argued that current microfinance literature do not sufficiently address the critical issue of MFI governance

(Benedetta et al, 2015). However, there have been studies which highlight issues of corporate governance practices in the microfinance sector, for instance, Hartarska (2005) argued that boards of directors are important in microfinance because of the limited role of external market forces and the fact that boards help to resolve the agency problems between owners of the microfinance organisation and the managers therein. Effective governance is certainly of crucial importance to the performance of MFIs (Bakker et al, 2014, 639) and a good governance framework should result in better outcomes for MFIs as regards sustainability and outreach, their double bottom line (Bakker et al, 2014, 640). For the reason that MFIs are supposed to sustain themselves whilst aiming to meet their objectives of social goals delivery, there is arguably more of an imperative that they are governed effectively. There is also evidence to suggest that corporate governance issues such as board diversity affects performance in MFIs (Hartarska, 2005). Also, Thrikawala et al (2015) have suggested that corporate governance practices certainly impact on the outreach of MFIs. According to Mersland and Strom (2007), governance is about achieving corporate goals and MFIs have multiple goals, with the fundamental one being to contribute to development. This implies that governance frameworks in the microfinance sector should be robust and enable the achievement of MFI goals. Augustine (2012, 13) suggests that microfinance institutions oriented towards good practice of corporate governance are more likely to outperform their peers. In relation to corporate governance in the microfinance sector specifically, Varottil (2013) argues that a meaningful governance framework must take cognisance of the clients and not just the providers of capital and there is a need for a well-defined set of corporate governance principles applicable to the microfinance sector, a model which balances the achievement of financial and social objectives.

It has been consistently submitted that the governance and regulation of MFIs needs to be tailored specifically to the needs and peculiarities of the microfinance sector (Ahmed et al, 2013; Varottil 2013). Hossain (2013) also argues that there can be no "one size fits all" approach to governance in microfinance institutions because of the peculiarities of that sector. The Council of Microfinance Equity Funds (2012) Governance Guidelines covers areas such as governance implications of MFI legal structures, unique governance issues for MFIs, structuring an effective MFI board, effective board processes and key board responsibilities and decisions. They indicate that even though many of the principles in their guidelines are similar to those indicated as essential for all types of institutions, MFIs have special characteristics which bear directly on governance and hence the tailoring of their principles to MFIs. The guidelines make reference to Elisabeth Rhyne (at p 4), who opines that good governance is the ability of board members to monitor the status of the organisation, make good strategic decisions and hold executives to account, and that ultimately effective corporate governance comes down to the quality of the board members, the culture and practise of the board and the power relationship among board members and executives. Also, Ahmed et al (2013) argue that good corporate governance can attract investors, donors and other stakeholders into MFIs and also thereby mitigate the costs of regulation for those entities.

Gadi et al (2015, 154 and 162) outline the regulatory framework for corporate governance in Nigeria and indicate from their research that there is a significant relationship between board composition and the composition of board committees; and the financial performance of microfinance banks in Nigeria. Visconti (2012, 32) also argues that corporate governance was considered one of the top risks in relation to microfinance in Africa and Benedetta et al (2015, 7) in their World Bank paper also discuss the pertinent reasons why it is crucially important to engage with corporate governance issues in the microfinance sector, and these reasons include the emergence of regulatory gaps. The authors explain that many MFIs have transformed into banks and deposit taking entities, and Central banks need to understand the best and most effective regulatory interventions which will ensure sound corporate governance in order to safeguard the MFIs and protect depositors. As regards the regulation of microfinance, the CGAP Consensus Guidelines indicate that regulators need to understand the distinctive characteristics of microfinance in order to be able to craft and enforce appropriate regulation (Christen et al, 2012, 8). Van Greuning et al (1998, 1) suggest a risk-based regulatory model for the microfinance sector and indicate that microfinance institutions operating in a financial systems context cannot develop adequately without a conducive regulatory environment. The authors also argue that it is crucial to consider whether the regulatory authorities have the capacity and resources for effective supervision of MFIs.

In relation to indicators of effective governance in the microfinance sector, Pistelli et al (2012, 4) argue that a good board should have the requisite knowledge and expertise, represent key stakeholders and maintain a significant degree of independence. They also indicate that the presence of board committees, risk management and audit functions are reflective of good governance practices. With regard to the issue of board members having the necessary qualifications and characteristics, the adoption of mechanisms such as a certification programme or a 'fit and proper' person test would be helpful and has been adopted in jurisdictions such as the United Kingdom (UK) (FCA website). Estape-Dubreuil and Torreguitart-Mirada (2015) also argue that governance practices differ significantly amongst MFIs depending on their legal status. The authors indicate that MFIs with NGO status appear to engage more with effective governance practices in line with the goals of microfinance. Mori (2010) highlights the important role of stakeholders in microfinance governance and operations, indicating the importance of engaging with stakeholders in order to achieve effectiveness in the governance of MFIs.

The corporate governance codes of countries around the world also advocate for stakeholder consultation and engagement and similar principles also exist in international governance instruments (UK Code 2014, G20/OECD Principles 2015). The G20/OECD principles encourages active co-operation between corporations and their stakeholders as a necessary element for effective governance in those corporations. Also, an essential element of an effective corporate governance system is the presence of adequate procedures for transparency and disclosures because these issues lead stakeholders to trust the organisation (Augustine, 2012, 14). Essentially, corporate governance in the microfinance sector is all about ensuring that governance is effected in a manner which achieves the objectives of shareholders and stakeholders, and that institutional arrangements are conducive to support the long term success of MFIs. Therefore, the shareholder theory (Sundaram and Inkpen, 2004), the stakeholder theory (Donaldson and Preston, 1995; Freeman et al, 2004), the institutional theory (Augustine, 2012) and the multi-dimensional governance theory (Christopher, 2010) are theoretical perspectives which are certainly relevant to the question of how microfinance governance is achieved in the context of countries such as Nigeria and Zambia.

**B. Methodology**

The research project upon which the findings in this paper are based was conducted in Nigeria and Zambia in July 2015. The two countries were selected because of the authors' familiarity with the locations, being that they originate from Nigeria and Zambia respectively. This familiarity enabled the availability of networks to support the research. The initial idea for the research project developed as a result of the realisation by the authors that both countries had developed their Microfinance Regulations at similar periods and had also embarked on revisions of the regulations within a similar timeframe. These issues then raised critical thoughts as to how effective the regulatory provisions had been in the two countries and the worthwhileness of engaging in an evaluation study. As much as both countries have some significant similarities in terms of the development of their microfinance regulations, there are certainly differences in relation to the development of their microfinance sub-sectors. As regards the details of the data collection, interviews were conducted with board members and executive management officers including CEOs in 8 microfinance institutions; with directors at the two regulatory institutions in both countries, Central Bank of Nigeria and the Bank of Zambia; with a director and the General Secretary at two apex microfinance associations, one in each country; and with two independent microfinance operators, one in each county. A total of 27 interviews were conducted, 14 in Nigeria and 13 in Zambia.

As regards the approach adopted, preliminary interview questions were developed after a review of the regulatory provisions and relevant literature. These questions were then pre-tested for clarity and relevance by sending them to a UK based CEO of a MFI which operates in Zambia. Subsequently, revisions were made based on the feedback received and then two sets of semi-structured interview questions were developed, one for the MFIs and the other for the regulators. The same questions were utilised in both countries, with flexibility to allow for contextual elements. The questions were exploratory in nature and related to issues bothering on the interviewees' perception of the regulatory provisions and their impact on the achievement of the aims and objectives of the regulators and the MFIs. All the participants were proficient in the English language and therefore all the interviews were conducted in that language.

Data Analysis

The key themes from all the interviews were elicited with the use of NVIVO software which, as argued by Patton (1990), is a useful tool for organising, managing and quantifying explicit and implicit themes and accompanying data. The data was transcribed and imported into the software, then triangulated and analysed until themes emerged. The common issues were identified and the differences in arguments were highlighted. Utilising the NVIVO software involved an iterative and reflexive process (O'Dwyer, 2004), as well as a careful engagement with the data. To enable a more in-depth and enhanced analysis of the relevant issues, secondary data was also obtained from the websites of microfinance institutions, the regulators, the apex associations, MIX market and other relevant sources. Although the sample used in this research may not be representative enough to draw general conclusions, the data certainly provides significant insights in relation to the impact of regulatory provisions on the governance of MFIs in Nigeria and Zambia.

## C. Microfinance Regulatory Landscape in Nigeria and Zambia

The foray into regulating microfinance activities in Nigeria began with the introduction of the Microfinance Policy, Regulatory and Supervisory Framework for Nigeria in December 2005 (MPRSF 2005). The policy document indicated in its introductory sections that robust economic growth cannot be achieved without the institution of programmes aimed at poverty reduction through empowering the people by increasing their access to factors of production, especially credit. The document also stated that microfinance is about providing financial services to the poor who are traditionally unserved by conventional financial institutions and the three distinguishing factors between microfinance and other formal financial products were the smallness of the loans and/or savings, the absence of asset-based collateral and the simplicity of operations. As at 2005, the statistics evidenced that the formal financial system provided services to about 35% of the economically active population, thereby leaving out 65% who were often served by the informal sector which included NGOs, moneylenders, relatives or informal credit associations (MPRSF 2005). From the perspective of the Central Bank of Nigeria, the fact that such large numbers of informal financial activities were being undertaken outside the purview of its regulation and supervision meant that there were implications as regards their objectives of promoting financial stability and maintenance of a sound financial system in the country. Therefore, a robust microfinance policy was essential to the achievement of these objectives as well as to ensure the integration of the microfinance sub-sector into the mainstream financial sector and promote the sustainability of that sub-sector (MPRSF 2005).

Considering the microfinance sub-sector as at 2005, the policy document indicated that the justifications for regulatory intervention was evident and these were the weak institutional capacity of community banks and microfinance institutions, weak capital base of existing institutions, the existence of a huge unserved population, economic empowerment of the poor, the need for increased savings opportunity, the interest of local and international stakeholders in micro financing and the utilisation of the Small and Medium Enterprises Equity Investment Scheme (SMEEIS) fund of which less than 30% had been utilised (MPRSF 2005). The policy targets included to cover the majority of the economically active poor by year 2020, thereby creating millions of jobs and reducing poverty, and to eliminate gender disparity by improving women's access to financial services. Consequently, the policy strategies were, amongst other issues, to licence and regulate the establishment of microfinance banks (MFBs) and to promote the establishment of NGO based microfinance institutions (MPRSF 2005). One of the issues stated as contributory to the weak institutional capacity of microfinance institutions as at 2005 was poor corporate governance and so one of the policy strategies was to promote sound microfinance practices by advocating professionalism, transparency and good governance in microfinance institutions.

In April 2011, the CBN revised the MPRSF. The revised policy indicated that the basis of the 2005 policy was still valid, however, the experiences of the CBN and the sector over the preceding years, global economic trends and the envisioned future for small business development in Nigeria necessitated a revision of the policy (Revised MPRSF 2011). The revised policy provides that following the 2005 policy and regulatory intervention, there had been an increased awareness among stakeholders such as governments, investors, development partners, and financial institutions as regards microfinance activities. This heightened awareness may be argued as reflected in the number of licenced MFBs. As at 2011, the policy document stated that the total number of licenced MFBs was 866, that number having increased in July 2015 to more than 900 as confirmed in our interview with CBN officials. As at May 2016, the CBN website indicated that there were 941 MFBs (CBN Supervisory Website). Despite the growth of MFBs, the revised policy indicated that a study carried out by EFInA (a financial sector development organisation funded by the UK government's Department for International Development and the Bill/Melinda Gates Foundation) revealed that as at 2010, 46.3% of adults in Nigeria were excluded from financial services. Of the 53.7% that had access to financial services, 36.3% of them derived their services from the formal financial institutions whilst 17.4% patronised the informal sector (Revised MPRSF 2011). Several factors were stated to have contributed to this gap in access to financial services including the uneven distribution of MFBs with preferences for particular sections of the country where business volume and profitability is higher, inefficiencies in the operations of MFBs, dearth of knowledge and skills, inadequate funds for intermediation, impact of the global financial crisis of 2007/2008 and the Nigerian banking sector reforms of 2009 (Revised MPRSF 2011). The revised policy also categorised MFBs into 3 types which are unit MFBs, state MFBs and national MFBs.

The revised framework provided a minimum standards/template for MFBs which is aimed at providing guidance on corporate governance, business planning, products, services and risk management (Revised MPRSF 2011). At this time, the CBN had instituted the Microfinance Certification Programme (MCP) to ensure the acquisition of microfinance skills by the management officers of MFBs. The revised framework also indicates that all MFBs are required to adhere to basic corporate governance principles and re-iterates the role of apex associations towards promoting good corporate governance practices. In December 2012, the CBN then issued a Revised Regulatory and Supervisory Guidelines for Microfinance Banks in Nigeria (Revised RSG 2012). The 2012 Guidelines provided in its introductory paragraph that the potential of microfinance in poverty reduction, economic growth and development has effectively put the issue of microfinance on the political agenda of most developing countries, and consequently, the supervisory authorities have instituted measures to ensure effective microfinance delivery through the development of an appropriate regulatory and supervisory framework. Some of the provisions of the 2012 Guidelines which were analysed and are relevant to the discussions on corporate governance in this paper are as follows: section 3.1 (ownership requirements), section 4.1 (board requirements), section 4.2 (certification requirements), section 5.3 (rendition of returns to the CBN), section 9.0 (assessment of soundness and adoption of a risk based approach to the supervision of MFBs), section 13.5 (internal controls and internal audit), and section 22.0 (minimum operational template for MFBs).

Unlike Nigeria, Zambia has no specific microfinance policy and therefore there is no basis for a detailed discussion as to the objectives of the regulations. However, microfinance is identified by the Bank of Zambia as one of the priority areas in the financial services sector development and the regulation of the microfinance sector began with the promulgation of The Banking and Financial Services (Microfinance) Regulations 2006 (BFSR 2006). This piece of regulation was not accompanied by a detailed policy document as was the case in Nigeria. The relevant provisions in relation to the discussions in this paper are as follows: section 14 (categorisation of microfinance institutions), section 20 (board requirements), section 22 (internal control), section 23 (fit and proper person requirements), section 35 (ownership), and section 37 (BOZ inspection of any microfinance institution and of its books or accounts).

From around 2011, Zambia embarked on revision of its microfinance regulation. The consultation document on the draft Banking and Financial Services (Microfinance) Regulations 2014 (Draft BFSR 2014) indicated that the BOZ had been highlighting the need for legal reform in the area of microfinance in order to ensure that the regulation remained current and relevant to microfinance activities, and to correct some shortcomings in the 2006 regulations (Draft BFSR 2014). One of the shortcomings of the 2006 regulations was the lack of clarity in terms of what microfinance delivery entailed and so the Draft BFSR 2014 stated that microfinance service means the provision of financial services to micro or small enterprises and low income customers usually characterised by the use of collateral substitutes except salary backed loans. The categorisation of MFIs was also changed to 3 tiers. Tier I refers to deposit taking MFIs, Tier II refers to non-deposit taking MFIs that meet the minimum paid up capital requirements of the BOZ and Tier III refers to non-deposit taking MFIs that do not meet the minimum paid up capital requirements of the BOZ and are registered as microfinance institutions with such a body as may be designated by the BOZ. Most of the provisions highlighted above in relation to the discussions on corporate governance have been retained in the Draft BFSR 2014 with the sections numbering changing for some of them. However, there are some new provisions in the revised regulation one of which is section 34 which provides that any microfinance institution that intends to open a branch shall seek the prior written approval of the BOZ. As at May 2016, the Draft BFSR 2014 is yet to become law. In any case, the regulatory intervention in the area of microfinance is viewed as positive and the interviews with BOZ officers indicated that it has also led to growth with the number of licenced MFIs at 36.

**D. Findings and Discussions**

1. **The rationale and aims of the regulatory intervention and the positive/negative impact on boards.**

The Nigerian CBN policy on microfinance clearly indicated that weak corporate governance in microfinance institutions was one of the aims of the regulatory intervention (MPRSF 2005; Revised MPRSF 2011) and the regulatory provisions contained sections on corporate governance. The BFSR 2006 and the draft BFSR 2014 Zambian regulatory provisions also contain elaborate sections on governance, an indication of the importance of that issue in relation to microfinance delivery. The interviews at the CBN highlighted some of the corporate governance problems which necessitated the foray into microfinance regulation, with an officer making statements such as that '*there were numerous corporate governance abuses such as board members taking loans and defaulting*' and '*capacity was poor on all levels, from top to bottom. The boards of these MFBs had little or no knowledge about how microfinance works*'. In Zambia, a BOZ officer stated that '*weak governance structures was part of the reason for regulatory intervention*'. Therefore, ensuring effective corporate governance was certainly at the heart of the regulatory efforts in both countries and rightly so because as indicated by Benedetta et al (2015), good corporate governance is critical to the success of microfinance institutions and the prevention of failures.

As regards the impact of the regulatory provisions on the boards of MFIs, the requirements under sec 4.1 of the Nigerian Revised RSG 2012 and sec 20 of the Zambian 2006 Regulations in relation to board membership, composition and characteristics appear to be robust enough to ensure effectiveness. Indeed, the interviews with the board members and management executives of the MFIs in both countries indicated that these provisions have contributed to positive outcomes in the governance of their institutions to the extent that they have established boards and board committees. A management executive in a Nigeria MFB stated that '*To some extent the [regulatory] provisions could be viewed as "positively* *limiting". In the area of corporate governance, the provisions help by instilling discipline within the system. The rules have enabled more effective governance regimes, we have boards that work. The rules have given us limited activities and help us to stay within our allowed remit. The CBN oversees our board appointments and removals etc. and also check our sources of funds. When you know someone is checking on you, you will check yourself*'. Another board member stated that '*The regulatory provisions help and we follow the CBN recommended operational template. At least the governance provisions ensure that we have an adequate board. We have 5 directors who are effective. We have a governance and remuneration committee. We have board committees on audit, risk management and internal control comprising of the heads of those departments*'. In another MFB, an executive officer stated that '*CBN regulations as to appointing directors are very good. Our own board is so effective because the members are knowledgeable and skilled*'. In Zambia, similar responses were given. At one of the MFIs, the executive officer explained that '*The BOZ guidelines as it relates to governance are just guidelines, but issues such as board self-assessment and the need to have committees example risk committee has helped. The governance aspects of the regulations has been positive, we now have better quality boards and committees*'. In relation to the draft regulations, an executive officer in another Zambia MFI stated that '*The 2014 regulation is good, issues of consumer protection and governance are key in it and that is good. The governance provisions will now be law and all MFIs will have to comply, they were previously just guidelines*'.

However, there are also some aspects of the regulatory provisions as regards board membership which could be argued to result in negative outcomes for the MFIs. First, section 4.1 of the Nigerian 2012 regulations states that a board member must not be an employee of a bank or other financial institution except if that bank or financial institution promoted the MFB and the proposed director is representing the interest of such an institution. Ordinarily, this stipulation is reasonable to the extent that it would prevent issues such as conflict of interest, but, considering the issue of availability of expertise for the governance and management of MFBs, this restriction becomes problematic. The microfinance sub-sector is one that is relatively new in many developing countries such as Nigeria and Zambia, and requires the recruitment of experienced board members who have financial industry experience at the least. Indeed, the Nigerian provisions indicate that at least 2 members of the board other than executive management should have such experience. But, with such restrictive stipulations, it might be difficult to recruit board members who have the requisite qualification and experience. In Zambia, this problem was particularly highlighted and one of the interviewees in a MFI stated that '*There is this regulation which says that if you are sitting on one board you cannot sit on another, so this restricts the size of the pool of people available for the task. This leaves MFIs struggling to attract skilled people as banks offer better incentives and besides we are competing with 26 commercial banks. So all these have to attract board members and consequently, MFIs are left with less skilled and credible people and not much spread in terms of specialisation'.*

Another issue as regards the regulatory provisions and boards of MFIs is the extent to which the provisions enhance adequate board composition. In both the Nigerian and the Zambian regulations, there are no provisions which mandate diversity on boards and stakeholder representation. There are arguments to the effect that these issues are important for the achievement of the objectives of MFIs, for instance, Zhang (2010) argues that diversity on boards enhances open discussions and reduces biases. Also, in their analysis of the impact of governance mechanisms on the performance of MFIs, Estape-Dubreuil and Torreguitart-Mirada (2015) indicated that board diversity had a positive impact. In relation to stakeholders, Mori (2010) identifies employees as key stakeholders in the microfinance project and argues that their contribution on boards could enhance performance and competency. Also, Varottil (2013) argues for client representation on boards of MFIs. Again, Hossain (2013) concluded from an analysis of empirical studies conducted in this area that diversified boards help in better strategic decision making, risk management and sustainability of MFIs. Gadi et al (2015) also submitted that there is a significant relationship between board composition and the financial performance of microfinance institutions. In view of these arguments, it could be stated that the absence of provisions relating to diversity and stakeholder representation on the boards of MFIs is a limitation as regards the effectiveness of the regulatory provisions. In truth, the provisions in the regulations have an impact on the composition of boards as much as the provisions left out of the regulations because the boards of MFI are mandated to abide by the regulatory provisions and may not engage with any other issues which are not mandated. As a matter of fact, the official interviewed at the CBN confirmed that MFBs in Nigeria did not render reports on any issues which were not mandatory under the regulations, so MFBs are unlikely to bother about ensuring that their boards are as diverse as is essential if they are not mandated to do so.

2. **The legal and organisational structure of MFIs in both countries inevitably leads to differing governance structures and implications.**

In Nigeria, the CBN regulations mandated the conversion of community banks and microfinance institutions into incorporated microfinance banks (MFBs), whilst the BOZ regulations allowed the existence of deposit taking and non-deposit taking MFIs. Unlike the case in Nigeria where the regulated MFIs had to be labelled as 'banks', the Zambian regulated MFIs could be incorporate companies or NGOs and did not have the same nomenclature. There are a number of governance implications that could result from the legal structure and ownership of MFIs. In Nigeria where the regulated MFIs are banks which can be established by individuals or private corporate entities (section 3.1 Revised RSG 2012), there is a tendency for their boards to be constituted and to operate in the same way as the boards of commercial banks. The danger in this labelling lies in the fact that the objectives of MFBs differ from those of commercial banks and the corporate governance provisions which would ensure the success of MFBs may not be exactly the same as would be required for a commercial bank. In the interview with CBN, an official stated that '*For the MFBs, the core challenge is that a lot of the actors in the sector, that is the people who set up MFBs and the people who were hired to run the businesses, came into that sector with their perception of how commercial banks operate*'. The official further explained that these MFBs adopt a mind-set of commercial banking and this leads to issues such as their boards undertaking unreasonable expenses to set up offices spaces, purchasing extravagant official cars, developing strategy which is similar to the mode of operation in commercial banks and placing their focus on profit generation on similar levels as required in commercial banks. MFBs generally operate with the culture of commercial banks as that is what they are used to and they also compete with commercial banks (Acha, 2012). Ulrich and Hoback (2014) also argued that the prevalence of board members and management in MFBs who are driven by past experiences of commercial banking rather than by microfinance principles/methodologies is one contributory factor to weak corporate governance in these institutions. An executive officer at an Apex Association of MFIs in Nigeria emphatically stated that '*CBN is getting it all wrong with MFBs. I have travelled to many countries and I do not see the models we practice here. I do not blame the MFBs. The CBN calls them 'banks' and banks are profit making entities. They adopt similar policies as commercial banks and just change their names*'.

Also, there is no specific corporate governance code for MFBs in Nigeria and one interviewee at a MFB stated that '*We use all the codes of corporate governance*'. Section 22.0 of the Revised RSG 2012 provides a template of minimum requirements which specifies the number of meetings and board committee constitutions etc., however, there are certainly corporate governance issues which are specific to microfinance institutions and a tailored corporate governance code would be more effective. In fact, arguments have been made that the governance and regulation of MFIs needs to be tailored specifically to the needs and peculiarities of the microfinance sector (Ahmed et al, 2013; Varottil 2013). An example of these peculiarities is highlighted in The Council of Microfinance Equity Funds (2012) Governance Guidelines which provides that Microfinance institutions operate commercially whilst maintaining social aims (the double bottom line), therefore, their boards should play an active role in advancing their social mission and one way of achieving this is to have a committee on the board that oversees this objective. It was clear from the interviews with MFBs in Nigeria that they had no such committee and the CBN regulation does not mandate it because, as highlighted in the interviews, it is not an issue which bothers on financial performance. Therefore, in Nigeria, the regulated MFBs are labelled as banks and operate as banks, without the recognition that they are banks with peculiar objectives which require peculiar corporate governance arrangements in other to help achieve those objectives. Essentially, the CBN regulations mandate this legal form but does not support its effectiveness as far as ensuring adequate corporate governance and achieving the goals of microfinance are concerned.

In Zambia, MFIs can operate as companies or NGOs without the pressure of being called banks and thereby having to operate the way commercial banks traditionally do. As far as governance practices go, Estape- Dubreuil and Torreguitart-Mirada (2015) argue that NGOs have more diversity in their boards and perform better as regards the delivery of social goals. Interestingly, the authors find that external governance mechanisms such as regulation do not have a significant impact on performance, but it could be argued that in cases where regulation is the reason why MFIs take particular legal forms and nomenclature such as banks or NGOs, then invariably, regulation impacts on the governance mechanisms in such legal forms such as board diversity which in turn impacts on performance. Although there is also no specific corporate governance code for MFIs in Zambia, the fact that regulated MFIs can operate as NGOs with a governance structure which is suited to microfinance delivery becomes a significant advantage as regards the success of microfinance delivery in that country. The reason why NGOs might have governance structures which are better suited to microfinance delivery is that usually they are managed by the owner-founders who have their focus on achieving the objectives of microfinance (Varottil, 2013; Benedetta et al 2015). So, for instance, such NGOs might have committees which oversee social goals delivery. As regards the non-NGO MFIs, the interviews indicated that they also competed with commercial banks. Therefore, even though the MFIs are not called banks (although the deposit-taking ones must be incorporated- section 35 BFSR 2006) and might not be under as much pressure to operate like the MFBs in Nigeria, there are still issues regarding their operations and this might be attributable to the fact that these MFIs function in the same financial market as commercial banks. These issues raise a pertinent question as to the legal form which might be best suited to the delivery of microfinance, with authors such as Estape-Dubreuil and Torreguitart-Mirada (2015) indicating that the NGO form might be better. Interestingly, most MFIs throughout the world take the form of NGOs (Benedetta et al, 2015). Arguably, the answer to the question might not lie as much in the specification of a particular legal form as it would lie in the issue of ensuring that whatever legal form is assumed by MFIs, the corporate governance arrangements are adequate and effective enough to ensure the success of the institution and the achievement of its goals and objectives.

## 3. The Nigerian CBN Certification Programme and the Zambia BOZ 'Fit and Proper' Test

Marulanda et al (2010) in their analysis of failures in microfinance institutions and lessons learned highlighted that in most of the cases studies, boards did not possess the information and skills needed to act. They argue, therefore, that MFIs should have minimum standards of suitability and knowledge in order for individuals to qualify as board members. The CBN regulations provide for a certification requirement under section 4.2 which states that top management staff are required to submit evidence of certification not later than 3 years after assumption of office and this microfinance certification programme is provided by the Chartered Institute of Bankers of Nigeria (CIBN). In Zambia, section 23 of the BFSR 2006 provides that a person shall not be appointed as Director, CEO, CFO or manager of a MFI if the person is not a fit and proper person in relation to the person's integrity and relevant knowledge. There are certainly problems with regard to these provisions. In relation to the Nigerian provisions, it is perplexing that the requirement allows for a board member or management staff to be in office and engage in decision making for a MFB for a period of 3 years without being certified. Clearly, the microfinance sector is a relatively new sub-sector in the financial services realm and the tendency is that people would have minimal knowledge of issues that are essential for operations in such a sector. Therefore, it surely makes sense for people to be certified before they are allowed to engage in the governance and management of such institutions or at the least within the shortest possible time.

A board member at a MFB in Nigeria stated that '*The CBN policy on certification should be a fundamental requirement before anyone can assume a managerial position. You can kill the bank before you acquire the certification, the 3 years grace period is too long*'. Indeed, a number of MFB licences have been revoked over the years, about 200 in 2010, 83 in 2014 and there were indications by the CBN in 2015 that yet more licences may be revoked for issues such as poor corporate governance and poor risk management (Center for Financial Inclusion Blog; New Mail 2014; Tribune Online 2015). Also, the fact that the certification programme is provided by the CIBN raises questions as to the competence of the CIBN to deliver such programmes. Surely, an institution with particular expertise in microfinance banking should be the preferred one as regards administering such a certification programme.

The provisions in Zambia are clear to the extent that the specified officers should be fit and proper persons. The problem, however, is that the regulations do not define the term 'fit and proper' and neither does it provide a clear and detailed criteria for determining this fitness and propriety in relation to integrity and relevant knowledge. For instance, in the UK, under the rules of the Financial Conduct Authority (FCA) certain officers who undertake controlled functions in the financial services sector are subject to a similar fit and proper test. However, the FCA Handbook specifies the most important considerations to which regard will be had in assessing fitness and propriety and these include honesty, integrity, reputation, competence, capability and financial soundness. Also, in relation to each of these considerations, the handbook specifies in great detail the main assessment criteria for determining if an individual is indeed fit and proper. Arguably, this is a better way of ensuring the effectiveness of such regulatory provisions. It is definitely short-sightedness to provide that persons should be fit and proper without indicating how such an assessment should be made. In the interview with an officer of the BOZ, when asked about this provision, the response was that '*We require that the [board] members are fit and proper. So we want those people who have an understanding of the business and a bit of experience in the financial sector and are educated to a certain level. We also subject these people to a security screening because we don't want people with questionable backgrounds to form part of these boards. The security screening is to check if they have any criminal records and things like that and also check from the database if a person was dismissed for dishonesty. After that we approve members that should sit on these boards. Further to that we also approve the CEO and the chief financial officer (CFO)'*.

It is evident from the statement above that there might be the intention to ensure that board members and management of MFIs are indeed fit and proper. However, it is also evident that the approach is far from robust because there are no clear procedures and detailed assessment criteria included in the regulatory provisions. Therefore, in the absence of a specified and transparent procedure indicated in the regulatory provisions, a particular BOZ official might render a judgment as to fitness and propriety which might differ from that made by another official. Again, the inclusion of detailed criteria and procedures in regulatory provisions enhances the likelihood of uniformity in application. The implication of ineffective regulatory provisions such as these is that persons might not be checked in the appropriate manner and if such persons end up on the boards of MFIs and turn out to be 'unfit and improper', then the result might be that such MFIs are poorly governed and could fail. The purpose of the regulatory intervention is to create effectiveness in this area, but this does not seem to be achieved by these provisions.

## 4. Supervision effectiveness and outcomes

In Nigeria, Section 9.0 of the Revised RSF 2012 provides that a more risk based approach to the supervision of MFBs would be adopted. The interviews with officers at the CBN highlighted that there are enormous challenges in the area of supervision of MFBs. In line with the tenets of regulatory supervision, an officer stated that '*The CBN conducts visits to MFBs once a year. The CBN is supported in these visits by the Nigerian Deposit Insurance Corporation (NDIC), so they carry out some of the visits and send reports to us. The MFBs send monthly returns electronically. The template is online and they fill in information on their income, expenditure, balance sheet, statements of liability, deposits, loans, credit etc*'. This explanation conforms with the provisions of Section 5.3 which deals with rendition of returns to the CBN including statement of assets and liabilities, credits to directors, management staff and related parties, profit and loss account and interest rate structure. However, the officer also stated that '*The workload of supervising MFBs within a tight budget is a huge challenge, it is difficult to supervise effectively within the human capital resources available. We try our best, but there is certainly a case here that we do not have enough people to undertake our functions*'.

On the part of the MFB operators, there was adequate corroboration of the fact that supervision by the CBN is insufficient and possibly ineffective. One of the executive officers interviewed stated that '*The CBN should conduct more off site supervision. Inspection visits once a year is not sufficient at this stage in the development of the sector. One year is a long time. It is not adequate*' and that '*One issue is the adequacy of the provisions, if they were adequate, MFBs will not be dying and losing their licences, about 100 lost their licences. One [supervision] visit a year like I noted earlier is certainly not sufficient for a sector like ours*'. Another board member's view was that '*CBN supervisors visit once a year and that is enough. We send monthly returns, they check the returns for the MFBs they consider important, they do not necessarily check the reports rendered by all MFBs. Sometimes, they use other agencies for the visits. This shows that the CBN staff cannot conduct visits to all MFBs. Maybe the CBN just focus on 5% of MFBs. They largely ignore the rest. They [CBN] are also not resourced properly'*. The evidence from these comments point to the argument that supervision by the CBN is problematic and this is a critical concern as regards ensuring that MFBs are adhering to regulatory provisions and managing their risks effectively. It is arguably a question of capacity, however, if the aim is to alleviate poverty and ensure economic growth through the microfinance sector, then it is certainly worthwhile to invest in the sector and this would necessarily include engaging more regulatory officers.

In Zambia, the situation as regards supervision is quite similar. Section 37 of the BFSR 2006 provides that The Bank of Zambia (BOZ) may at any time cause an inspection to be made of any microfinance institution and of its books or accounts. The BOZ officer interviewed stated that '*DT MFIs send in monthly returns which we review. We use a risk based model for our inspection visits and that determines which MFIs to focus on. We endeavour to inspect every DT MFI at least once in 2 years*'. The officer also stated that '*Challenges to supervision include the limited number of staff we have compared to the number of MFIs*'. The MFIs confirmed these challenges with comments such as '*The BOZ do not have the capacity and manpower to carry out regular on-site inspections of MFIs. In terms of off-site, we submit monthly returns and they will look at them and query. We have only been inspected once in 2012 after we got our licence in 2009. You would expect that we would have an inspection at least once a year, but it is not happening*'. It is somewhat surprising to find that a developing sector such as the microfinance sub-sector is largely ignored in terms of supervisory visits. When MFIs are not supervised effectively, it could lead to similar situations as has been seen in Nigeria where issues such as poor risk management and poor corporate governance practices result in licences being revoked. According to Van Greuning et al (1998), it is certainly crucial to consider whether regulators have the capacity and resources to undertake their supervisory functions effectively.

## 5. Consultation process with stakeholders

The role of stakeholders such as owners/operators of microfinance institutions and apex associations of such institutions is key to the achievement of the objectives of these institutions (Revised MPRSF 2011). Consultations with stakeholders is usually a precursor to the development of regulatory provisions including those in the sphere of corporate governance as is evident, for instance, in the Financial Reporting Council's engagement with stakeholders (FRC 2014). The interviews conducted in Nigeria and Zambia indicated that the principle and process of consultation with MFBs, MFIs and apex associations is problematic and less than effective. The evidence for this state of affairs included that the regulators developed provisions which affected microfinance institutions without consulting the operators and the apex associations were not performing their functions effectively. In Nigeria, the CBN officers stated categorically that stakeholders were consulted when new policies were promulgated. However, the impression from the MFB operators was mixed and somewhat different from the position of the CBN. One of the executive officers in a MFB stated that '*Yes, we are engaged in consultations but I do not know if all MFBs are involved, especially the smaller ones. It seems like the CBN only engages with bigger MFBs*'. In another MFB, the view was that '*The CBN engages with us in the development of policies through COMBIN (a group for banks). They give the impression that they listen to us but the evidence is in the end product, the policies, sometimes our views are not reflected therein. So, appearing to consult with us is one thing, but actually taking on board our views is another thing*'. These comments show that the spirit and principle of engaging in consultations is not actually met by the CBN. The problem with this sort of situation is that the legitimacy/acceptability of the regulatory provisions and indeed their effectiveness becomes questionable if the stakeholders such as the microfinance institutions are not involved in their development.

The MFIs in Zambia also argued that there was poor consultation with the operators in the development of some of the BOZ policies. In relation to the interest rate cap for MFI loans which was effected by the BOZ, one of the interviewees said '*Even the BOZ know that the cap was just political, no business case for it. After it, they engaged FINMARK TRUST to research the impact of it, we contributed to that but we have not seen the result of that investigation up till today*'. This comment illustrates that consultation are presumably undertaken but they are not exactly utilised in a meaningful manner and the MFI operators are not kept in the loop. The BOZ stated in their interview that stakeholders are consulted in the development of policies and as regards the draft BFSR 2014, one of the MFI executive officers stated that '*As it stands, I feel that this regulation has to a large extent the representation of the views of the industry. I know that there has been active engagement with the industry and we are yet to see when it will come into effect. MFI CEOs have been part and parcel of the process. I feel it will be a highly representative regulation than the current one*'. It appears that the BOZ did not engage in adequate consultation prior to the 2014 Draft Regulation, but has now become more receptive. In any case, the comments seem to indicate that the consultation process is not as effective as it should be, with one Zambia MFI board member putting forward categorically that '*These regulations are dropped on MFIs from on high*'.

## E. Conclusion and Recommendations

This paper has discussed the regulatory intervention in Nigeria and Zambia in the area of microfinance. Considering the import of microfinance and its aims and objectives as evidenced in the literature, an evaluation of the corporate governance provisions and its potential to achieve the regulatory aims in both countries was undertaken with particular references to interviews conducted with officers of the CBN and BOZ, as well as some MFBs and MFIs in both countries. The significant and novel contribution of this paper lies in the identification and discussion of 5 key findings which indicate the limitations of regulatory intervention in these areas and provides in-depth analysis which would contribute to enhancing the effectiveness of such regulatory provisions. The recommendation that is evident from all the analysis is that regulators must ensure that the corporate governance provisions are indeed fit for purpose because the microfinance sub-sector is one which is peculiar and its success is largely dependent on the effectiveness of its corporate governance mechanisms. The most recent 2014 EFInA access to financial services data indicates that 36.9 million adults in Nigeria, representing 39.5% of the population are still financially excluded (EFInA website). This clearly indicates that more efforts need to be extended towards ensuring that microfinance works effectively and part of that is developing robust regulatory provisions which enhance effective corporate governance and therefore contribute meaningfully towards the successful achievement of the goals of microfinance in developing economies such as Nigeria and Zambia. In terms of future research in this area, one limitation of this research project was the limited number of microfinance institutions involved in the interviews and so, it would be worthwhile to conduct more research on the effectiveness of corporate governance provisions using data from more sources. In any case, this limitation is not a significant one as regards this particular study because its aim was to elicit qualitative data and that was achieved. Also, this research project did not include the views of clients. It would be valuable to engage clients in the determination of the effectiveness of regulatory provisions in the area of microfinance.

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